BHP PETROLEUM (AMERICAS) INC.

IBLA 91-126 Decided October 14, 1992

Appeal from a decision of the Deputy to the Assistant Secretary - Indian Affairs (Operations), affirming an order to calculate and pay additional royalties. MMS-90-0059-IND.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas Leases: Royalties: Generally

   MMS properly required a Federal and Indian oil and gas lessee to review royalty accounts in order to determine whether royalty underpayment was caused by exclusion of state tax reimbursements from gross proceeds of sales
   of oil and gas.

2. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas Leases: Royalties: Generally

   The Federal and Indian lessee was properly required to compute and pay additional royalties where there was evidence of systematic exclusion of tax reimbursements in reporting production proceeds for royalty purposes.

3. Administrative Authority: Generally

   A statute establishing time limitations for commencement of civil actions for damages by the United States does not apply to limit administrative action by the Department.

APPEARANCES: Hugh V. Schaefer, Jr., Esq., Denver, Colorado, for appellant; Howard W. Chalker, Esq., Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Department.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

BHP Petroleum (Americas) Inc. (BHP) has appealed from a decision of the Deputy to the Assistant Secretary - Indian Affairs (Operations), dated

September 20, 1990, affirming an October 19, 1989, order of the Houston Regional Compliance Office (HRCO), Minerals Management Service (MMS), that required recalculation and payment of additional royalties.

On August 26, 1987, HRCO informed BHP there would be an audit of royalties paid by BHP on oil and gas produced from Federal and Indian leases from September 1, 1981, through August 31, 1987. On October 19, 1989,
HRCO determined that BHP had systematically failed to include in royalty calculations payments made by oil and gas purchasers to reimburse BHP for State ad valorem taxes paid. This conclusion was derived, in part, from a November 12, 1987, BHP memorandum, to the effect that ad valorem tax reimbursements were to be excluded from gross proceeds for royalty computation purposes, a policy that a HRCO audit showed conformed to company practice in the case of royalty payments made for production from the Pfeiffer No. 1-10 well in 1985. HRCO concluded that "BHP's practice of not including reimbursed ad valorem taxes in its royalty base has resulted in * * * royalty underpayments to Federal and Indian lessors" (Letter to BHP, dated Oct. 19, 1989, at 5).

In order to collect the correct amount of royalty owed as a consequence of this perceived practice, HRCO first directed BHP to provide a list of "all Federal and Indian leases on which amounts reimbursed or reimbursable for taxes were excluded from value used as a basis for MMS royalty payment from September 1, 1981, through the current production month." The list
was to include all leases for which BHP was reimbursed or was entitled to reimbursement from purchasers for taxes paid on its own behalf and on behalf of other working interest owners. BHP was also required to produce documents supporting both payment of taxes by BHP and reimbursements for taxes paid made to BHP by purchasers of oil and gas. Finally, HRCO required BHP to "calculate and pay the additional royalties due on tax reimbursements not included in the value used as the basis for royalty payments to MMS from September 1, 1981, through the current production month." BHP was
then to pay additional royalties due on account of reimbursements received from purchasers for taxes paid on its own behalf and on behalf of other working interest owners.

BHP timely appealed HRCO's October 1989 letter to the Director, MMS, objecting that it was being required to perform a "self-audit" of its
own royalty accounts contrary to statutory authority that vested auditing responsibility in MMS. BHP asserted also that MMS could not charge royalty against tax reimbursements received from purchasers on the sale of
oil and gas produced from Federal and Indian leases, since to do so would
be contrary to law. Finally, it was argued that the collection of additional royalties incurred more than 6 years prior to the date of the letter demanding payment was barred by the 6-year statute of limitations at 28 U.S.C. § 2415(a) (1988). In his September 1990 decision, the Deputy
to the Assistant Secretary affirmed that BHP was required to compute and
pay royalties by including tax reimbursements received for production of
oil and gas from Federal and Indian leases. While BHP initially challenged
the inclusion of tax reimbursements in gross proceeds, it has declined
to pursue the issue further after the decision in Mesa Operating Limited Partnership v. United States, 931 F.2d 318 (5th Cir. 1991), cert. denied,

112 S. Ct. 934 (1992). See Statement of Reasons (SOR) at 2-3. Therefore, that issue is not before us.

Aside from affirming the principle that tax reimbursements were to be charged royalty, the Deputy to the Assistant Secretary, in his September 1990 decision, affirmed the directives of the October 1989 MMS letter that required BHP to identify leases for which BHP had failed to include tax reimbursements when calculating royalty, to supply appropriate supporting documentation regarding the actual amount of taxes paid by BHP and the corresponding amounts reimbursed by purchasers, and to then calculate and pay additional royalties owing on account of the tax reimbursements. The first question before us is therefore whether MMS may, in requiring BHP to compute and pay additional royalty due on account of State ad valorem tax reimbursements, properly require BHP to review its own records. BHP contends that by issuing this order MMS abdicated a statutory duty under section 101(c)(1) of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), 30 U.S.C. § 1711(c)(1) (1988), to "audit and reconcile" royalty accounts.

[1] Section 101(c)(1) of FOGRMA requires the Secretary of the Interior and his designated delegates to "audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas." Id. It is clear that the order issued by MMS will require expenditure of effort by BHP employees. BHP must first review its royalty accounts to determine whether royalties were in fact properly paid. Nonetheless, there is nothing in section 101(c)(1) of FOGRMA to prohibit such an order. It is clear that Congress, in enacting FOGRMA, sought to avoid a royalty accounting and collection system operating entirely on the honor principle, with no verification of production and sales data, since this sort of arrangement had led to under-reporting of production and sales in the past. See H.R. Rep. No. 859, 97th Cong., 2d Sess. 15, 16 (1982), reprinted in 1982 U.S. Code Cong. & Admin. News 4268, 4269, 4270. The statute required instead that the Secretary and his delegates were to audit and reconcile lease accounts. However, Congress was also aware that "auditing every account on an annual basis is clearly impractical." H.R. Rep. No. 859, 97th Cong., 2d Sess. 33 (1982), reprinted in 1982 U.S. Code Cong. & Admin. News 4268, 4287. With this practical consideration in mind, the Secretary was to audit and reconcile accounts only "to the extent practicable." 30 U.S.C. § 1711(c)(1) (1988). The statute does not restrain the Secretary from directing a royalty payor to review royalty accounts in order to uncover underpayment traceable to an identified defect in the payor's original calculation of royalties due. Indeed, MMS states that because it is impractical to audit every account of a royalty payor the practice has been to sample certain leases and certain production months, leaving the payor the burden to uncover all other instances of systemic deficiency.

[2] MMS required BHP to calculate the correct amount of royalty that should have been paid. There is nothing in the language of FOGRMA or the legislative history to suggest that Congress intended to place the burden for royalty determination on the Secretary in the first instance. To do so would be contrary to the duty generally imposed on Federal and Indian oil and gas lessees to determine and pay royalties to the United States.

See 30 U.S.C. § 226(b) (1988); 25 U.S.C. § 396d (1988); 43 CFR 3103.3-1(a); 25 CFR 211.13(a); 25 CFR 212.16; BWAB, Inc., 121 IBLA 188, 191 (1991). BHP was not required by the October 1989 MMS letter to do anything it was not initially required to do as a royalty payor. It was required to determine the correct amount of royalty due the United States and to pay that amount.

Moreover, section 101(c)(1) of FOGRMA requires the Secretary to "take appropriate actions to make additional collections * * * as warranted." 30 U.S.C. § 1711(c)(1) (1988). We conclude that the action taken by MMS in the October 1989 letter requiring BHP to review its records, determine the additional royalty due with respect to tax reimbursements, and ultimately to pay that amount rests on this statutory authority. See Amoco Production Co., 123 IBLA 278, 285 (1992). Indeed, the court in Phillips Petroleum Co. v. Lujan, 963 F.2d 1380, 1386 (10th Cir. 1992), approved a requirement that a lessee recalculate all royalties for a given time if MMS should discover a "'systemic deficiency'" in royalty calculations. The court concluded that this would not be prohibited by FOGRMA, but rather "falls squarely within the purposes of the FOGRMA." Id.

BHP decided to exclude tax reimbursements from gross proceeds for royalty computation purposes and did so. The argument by BHP that, despite the audit of BHP's royalty accounts, MMS was only able to discover one underpayment due to the exclusion of tax reimbursements from a royalty base, that being the Pfeiffer No. 1-10 well, is irrelevant. See Letter to MMS, dated Feb. 8, 1990, at 2; SOR at 3-4. There is no evidence in the record regarding the extent to which MMS, during the audit of BHP's royalty accounts, actually looked for other instances where BHP had underpaid royalties due to the exclusion of tax reimbursements. The October 1989 MMS letter indicates that, with one exception, it did not do so. Rather, MMS concluded that BHP's policy, as expressed on November 12, 1987, was to generally exclude such reimbursements. This conclusion was "confirm[ed]" by looking at records for royalty paid with respect to production in one year from the Pfeiffer No. 1-10 well (Letter to BHP, dated Oct. 19, 1989, at 4). Significantly, BHP does not deny that this was its practice. It is, therefore, likely that there will be other instances where BHP underpaid royalty because tax reimbursements were excluded from the royalty base during the period from September 1981 through October 1989. We conclude that there is evidence that BHP failed to include tax reimbursements in gross proceeds for royalty computation purposes as a general policy and that MMS may, pursuant to the statutory obligation to ensure that proper royalties are paid, require BHP to determine the extent to which underpayment has been made and then to recalculate and pay the proper royalties due. See Amoco Production Co., supra at 282.

BHP also argues that it was improperly required by the October 1989 MMS letter to "prepare and provide [MMS] with copies of all 'workpapers' used to recalculate royalties owed" (SOR at 6). BHP argues that this is contrary to the dictates of section 103(a) of FOGRMA, 30 U.S.C. § 1713(a) (1988), since such papers are not among the "information" that a royalty payor is required by rule" to establish and make available to MMS. See also Letter to MMS, dated Feb. 8, 1990, at 5-7. Nothing in MMS' October 1989 letter, however, required BHP to prepare and provide MMS with copies of workpapers used to

calculate the additional royalties now deemed to be due. At best, HRCO stated that "[a]ll supporting calculations and source documents should be retained until MMS completes its follow-up compliance testing" (Letter to BHP, dated Oct. 19, 1989, at 6 (emphasis added)). We therefore are not confronted with the need to adjudicate the propriety of any requirement to prepare and submit workpapers under 30 U.S.C. § 1713(a) (1988).

BHP was, however, required by MMS to provide a list of all Federal and Indian leases that had excluded tax reimbursements from gross proceeds for royalty computation purposes for payments made from September 1981 through October 1989. The BHP memorandum dated November 12, 1987, listed some leases of this type. In addition, MMS required BHP to submit "tax reports and computations" and "billings and receipts," to prove that it had paid State taxes on oil and gas production from Federal and Indian leases and been reimbursed for such payments by purchasers of the oil and gas (Letter to BHP, dated Oct. 19, 1989, at 5). Such documents are required to be made and retained by 30 CFR 212.51(a), which applies broadly to "records necessary to demonstrate that payments of * * * royalties * * * are in compliance with * * * regulations." Moreover, we conclude that MMS is authorized to require the preparation and submission of such documents by section 107(a) of FOGRMA, 30 U.S.C. § 1717(a) (1988), providing that the Secretary and his delegates may conduct any inquiry "necessary and appropriate" to carrying out his duties under FOGRMA. See Phillips Petroleum Co. v. Lujan, 951 F.2d 257, 260 (10th Cir. 1991); Amoco Production Co., supra at 285.

[3] Finally, BHP contends that collection of additional royalties that became due prior to October 19, 1983, or more than 6 years before the October 1989 letter requiring payment, is barred by the statute of limitations at 28 U.S.C. § 2415(a) (1988). That statute provides, in relevant part, that "every action for money damages brought by the United States * * * which is founded upon any contract * * * shall be barred unless the complaint is filed within six years after the right of action accrues."
Id. While MMS may be prevented by 28 U.S.C. § 2415(a) (1988) from obtaining judicial relief on a claim for royalties where the obligation to pay arose more than 6 years prior to the filing of the claim with a court, an administrative claim for royalties is not precluded by that statute even where more than 6 years have elapsed since the obligation to pay the royalty arose. Amoco Production Co., supra at 281; Mobil Exploration & Producing U.S., Inc., 119 IBLA 76, 81, 98 I.D. 207, 210 (1991). We find therefore that 28 U.S.C. § 2415(a) (1988) did not bar MMS in October 1989 from requiring BHP to pay additional royalties that became due more than 6 years before payment was claimed.

Accordingly, we conclude that the Deputy to the Assistant Secretary, in his September 1990 decision, properly required BHP to compute and pay additional royalties due because BHP failed to include State ad valorem
tax reimbursements in gross proceeds when computing royalty for oil and
gas production from Federal and Indian leases from September 1981 through October 1989. We find also that BHP should provide a list of affected leases and documentation of taxes paid to the State and reimbursed by purchasers of the oil and gas and affirm the directive that it do so.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Franklin D. Arness
Administrative Judge

I concur:

James L. Burski
Administrative Judge